

Message Text

UNCLASSIFIED

PAGE 01 LONDON 10193 01 OF 02 211214Z
ACTION EUR-12

INFO OCT-01 EA-09 ISO-00 AID-05 CIAE-00 COME-00 EB-07
FRB-01 INR-07 NSAE-00 USIA-15 XMB-04 OPIC-06
SP-02 LAB-04 EPG-02 SIL-01 OMB-01 NSC-05 SS-15
STR-04 CEA-01 L-03 H-02 PRS-01 PA-02 AGRE-00
/110 W

-----025930 211240Z /46

R 211201Z JUN 77

FM AMEMBASSY LONDON
TO SECSTATE WASHDC 5310
TREASURY DEPT WASHDC
INFO AMEMBASSY BONN
AMEMBASSY BRUSSELS
AMEMBASSY PARIS
AMEMBASSY ROME
AMEMBASSY TOKYO

UNCLAS SECTION 01 OF 02 LONDON 10193

USEEC ALSO FOR EMBASSY
USOECN ALSO FOR EMBASSY

DEPARTMENT PASS FEDERAL RESERVE BOARD

E.O. 11652: N/A
TAGS: EFIN, UK
SUBJECT: BANK OF ENGLAND QUARTERLY BULLETIN

SUMMARY: THE BANK OF ENGLAND'S LATEST QUARTERLY BULLETIN
PRESENTS A POLICY ASSESSMENT LOOKING BEYOND THE IMMEDIATE
ECONOMIC SITUATION WHICH IS CHARACTERIZED AS "RELATIVELY
UNEVENTFUL". THE IMPORTANCE OF PROFITS AND THE ROLE OF
MONETARY TARGETS ARE THE PRINCIPAL AREAS OF DISCUSSION.
END SUMMARY.

1. PROFITS. NOTING THAT THE REAL RATE OF RETURN ON COR-
UNCLASSIFIED

UNCLASSIFIED

PAGE 02 LONDON 10193 01 OF 02 211214Z

PORATE ASSETS HAS FALLEN BELOW THE REAL COST OF CAPITAL
EACH YEAR SINCE 1973, THE BANK STRESSES NEED FOR IMPROVE-
MENT IN THE PROFITABILITY OF U.K. INDUSTRY. CONTINUING
A PATTERN BEGUN IN THE LATE 1960'S, THE REAL RATE OF RE-
TURN REACHED A LEVEL IN 1975 AND 1976 JUST ONE-THIRD THAT
PREVAILING IN 1965. PART OF THIS IS ATTRIBUTED TO CYCLI-
CAL FACTORS. HOWEVER. THESE HAVE BEEN LONG-LIVED AND MAY

WELL MEAN THAT FULL RECOVERY WILL BE DIFFICULT FOR THE U.K. IF IT MUST RELY SOLELY ON ITS OWN RESOURCES. THUS, THE BANK MENTIONS THE IMPORTANCE OF RECOVERY IN OTHER COUNTRIES AS A MEANS OF PROVIDING ADDED IMPETUS. ACCORDING TO THE BANK SUCH ASSISTANCE MAY NOT BE AS GREAT AS MIGHT BE HOPED SINCE OTHER COUNTRIES ALSO FACE THE NEED TO REIN IN INFLATION. A SLOW UPTURN WILL EFFECT THE RECOVERY OF U.K. PROFITABILITY. HOWEVER, IN THE ABSENCE OF SUCH A RECOVERY, BRITAIN'S LONGER TERM PROSPECTS COULD BE SERIOUSLY DAMAGED AS INVESTMENT IS LIKELY TO FALL SHORT OF THE LEVEL NEEDED TO SUSTAIN GROWTH. THE BANK ADDS THAT WHILE PROFITS BEGAN TO RECOVER IN 1976, PART OF THE IMPROVEMENT WAS ATTRIBUTABLE TO RAPIDLY INCREASING NORTH SEA OIL OUTPUT WHOSE EFFECT IS LIMITED TO RELATIVELY FEW FIRMS. FOR THE BULK OF U.K. COMPANIES' THE RECOVERY IN PROFITS WAS LESS PRONOUNCED.

2. MONETARY TARGETS. THE BANK DEVOTES CONSIDERABLE SPACE TO A DISCUSSION OF MONETARY TARGETS. INTRODUCED IN THE U.K. FOR THE FIRST TIME IN 1976. IT STATES THAT "PRIOR ANNOUNCEMENT OF TARGETS MAY REINFORCE THE PURPOSE-IVENESS OF MONETARY POLICY AND PROVIDE ASSURANCE THAT THE AUTHORITIES WILL NOT JUST ACCOMMODATE TO PRESSURES WHICH MAY ARISE." IT IS STRESSED THAT IN TIMES WHEN THE BALANCE OF PAYMENTS IS STRENGTHENING, M3 RATHER THAN DOMESTIC CREDIT EXPANSION TARGETS SHOULD RECEIVE GREATER UNCLASSIFIED

UNCLASSIFIED

PAGE 03 LONDON 10193 01 OF 02 211214Z

EMPHASIS BECAUSE OF THE ADDITION TO GROWTH OF M3 RESULTING FROM A BALANCE OF PAYMENTS SURPLUS. THE RADICAL CHANGE IN FINANCIAL CLIMATE OVER THE LAST YEAR IS ATTRIBUTED TO A SHARP CHANGE IN THE RATE OF MONETARY EXPANSION. THESE WERE DUE IN PART TO THE CHANGING STATE OF BUSINESS CONFIDENCE IN THE GOVERNMENT'S ECONOMIC POLICY.

THE BANK REPLIED TO CRITICS WHO EXPRESSED CONCERN OVER THE FALL IN THE MONETARY AGGREGATES DURING THE LAST SIX MONTHS. IT FIRST EMPHASIZED THAT ALTHOUGH THE BANK MAY HAVE MONETARY TARGETS, IT DOES NOT CONTROL THE MONETARY AGGREGATES DIRECTLY. BUT RATHER INDIRECTLY, THROUGH, FOR EXAMPLE, THE SALE OF GILTS. LAGS IN COLLECTING AND COMPILING DATA MEAN THAT GILT SALES ARE IN FACT CARRIED OUT WITHOUT HAVING PRECISE KNOWLEDGE (ALBEIT WITH CAREFUL ESTIMATES) OF THE ACTUAL LEVEL OF THE PUBLIC SECTOR BORROWING REQUIREMENT AND THE LEVEL OF THE MONETARY AGGREGATES AT THE MOMENT OF SALE. THE BANK, A FORTIORI, MUST WAIT TO SEE IF ANY DEVIATION FROM ITS TARGET IN FACT INDICATES A DEVIATING TREND.

THE BANK, IN A SECOND POINT, REPLIED THAT THE EFFECT OF CHANGES IN THE MONEY STOCK ON LEVELS OF OUTPUT, EM-

PLOYMENT AND INFLATION IS FELT ONLY OVER TIME. LONG LAGS, SUCH AS THOSE FOR STOCKBUILDING AND FIXED INVESTMENT WHICH MAY EXCEED TWO YEARS, DAMPEN SHARP SHORT-TERM MONETARY MOVEMENTS.

UNCLASSIFIED

NNN

UNCLASSIFIED

PAGE 01 LONDON 10193 02 OF 02 211211Z
ACTION EUR-12

INFO OCT-01 EA-09 ISO-00 AID-05 CIAE-00 COME-00 EB-07
FRB-01 INR-07 NSAE-00 USIA-15 XMB-04 OPIC-06
SP-02 LAB-04 EPG-02 SIL-01 OMB-01 NSC-05 SS-15
STR-04 CEA-01 L-03 H-02 PRS-01 PA-02 AGRE-00
/110 W

-----025915 211240Z /46

R 211201Z JUN 77
FM AMEMBASSY LONDON
TO SECSTATE WASHDC 5311
TREASURY DEPT WASHDC
INFO AMEMBASSY BONN
AMEMBASSY BRUSSELS
AMEMBASSY PARIS
AMEMBASSY ROME
AMEMBASSY TOKYO

UNCLAS SECTION 02 OF 02 LONDON 10193

3. TO REDUCE THE DIFFICULTY OF JUDGING THE STATE OF CURRENT FINANCIAL CONDITIONS, THE BANK OF ENGLAND IS CURRENTLY CONSIDERING THE FEASIBILITY OF COLLECTING WEEKLY MONETARY DATA. THE BANK'S ABILITY TO CARRY OUT MONETARY POLICY SMOOTHLY UNDER A VARIETY OF CONDITIONS HAS FURTHERMORE BEEN ENHANCED BY THE INTRODUCTION OF VARIABLE INTEREST BONDS AND BONDS WHOSE PAYMENTS ARE STAGGERED OVER MANY WEEKS.

4. THE BANK COMPLETES ITS ASSESSMENT BY NOTING THAT THE CURRENT M3 TARGET, 9 TO 13 PERCENT, IMPLIES THAT FOR REAL GROWTH TO BE ACCOMMODATED, THE RISE IN WAGE COSTS "WILL NEED TO BE SIGNIFICANTLY BELOW THIS..." IT ADDS THAT THE

RECENT DECLINE IN INTEREST RATES PROBABLY REFLECTED EX-
UNCLASSIFIED

UNCLASSIFIED

PAGE 02 LONDON 10193 02 OF 02 211211Z

PECTATIONS OF LOWER PRICE INFLATION. INTEREST RATES
COULD RISE IF THIS IMPROVEMENT FAILS TO OCCUR. IT CON-
CLUDES "A MONETARY POLICY GEARED TO A PUBLIC MONETARY TAR-
GET IS A SEMI-AUTOMATIC WAY OF HELPING TO ACHIEVE SUCH AN
AIM (RESISTING INFLATION). IT MAY NOT BE COMPLETELY SUF-
FICIENT. BUT IT WILL WORK IN THE RIGHT DIRECTION. IT
DOES NOT RULE OUT DISCRETIONARY DEMAND MANAGEMENT, BUT IT
WILL HELP TO MAKE IT LESS NECESSARY."

5. COMMENT: THE BANK'S REPLY TO ITS CRITICS HAS ELICIT-
ED RESPONSES. THE LATEST MONTHLY BULLETIN OF THE PROMI-
NENT STOCKBROKER, W. GREENWELL AND CO., QUESTIONS WHETHER
A SIX-MONTH DECLINE COULD BE REGARDED AS A SHORT-TERM
VARIATION. THE BULLETIN NOTES IN PARTICULAR THAT THE AN-
NUALIZED DECLINES (A) IN REAL M1 OF 17 PERCENT OVER THE
LAST SIX MONTHS AND 8 PERCENT OVER THE LAST YEAR, AND
(B) IN REAL TOTAL M3 OF 18 PERCENT OVER THE LAST SIX
MONTHS AND 8 PERCENT OVER THE YEAR, APPEAR TO BE AMONG
THE MORE SEVERE DECLINES OF THE PAST TWENTY YEARS. GREEN-
WELL'S DOES NOT GIVE THE BANK'S REFERENCES TO "FINANCIAL
READJUSTMENTS" AS THE CAUSE OF THE CONTRACTION A GREAT
DEAL OF WEIGHT, AND CONTINUES TO FORECAST A RECESSION.

6. WHILE THIS DEBATE IS FAR FROM SETTLED, IT IS CLEAR
THAT THE BANK'S ELUCIDATION OF THE ROLE OF MONETARY TAR-
GETS HAS MOVED THE FOCUS OF DISCUSSION A CONSIDERABLE
DISTANCE TOWARD THE MONETARIST CAMP. IT REPRESENTS AN-
OTHER STEP AWAY FROM THE TRADITIONAL HMTREASURY AND BANK
OF ENGLAND METHOD OF ECONOMIC POLICY MANAGEMENT WHICH UN-
TIL LAST YEAR HAD FOCUSSED, SOMETIMES VIRTUALLY EXCLUSIVE-
LY, ON THE BEHAVIOR OF REAL RATHER THAN FINANCIAL AGGRE-
GATES.

UNCLASSIFIED

UNCLASSIFIED

PAGE 03 LONDON 10193 02 OF 02 211211Z

BREWSTER

UNCLASSIFIED

NNN

Message Attributes

Automatic Decaptioning: X
Capture Date: 01-Jan-1994 12:00:00 am
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: ECONOMIC CONDITIONS, BANKS, QUARTERLY REPORTS, FINANCIAL TRENDS
Control Number: n/a
Copy: SINGLE
Sent Date: 21-Jun-1977 12:00:00 am
Decaption Date: 01-Jan-1960 12:00:00 am
Decaption Note:
Disposition Action: n/a
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment:
Disposition Date: 01-Jan-1960 12:00:00 am
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1977LONDON10193
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Expiration:
Film Number: D770221-0165
Format: TEL
From: LONDON
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1977/newtext/t19770636/aaaabfft.tel
Line Count: 217
Litigation Code IDs:
Litigation Codes:
Litigation History:
Locator: TEXT ON-LINE, ON MICROFILM
Message ID: 8b506479-c288-dd11-92da-001cc4696bcc
Office: ACTION EUR
Original Classification: UNCLASSIFIED
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 4
Previous Channel Indicators: n/a
Previous Classification: n/a
Previous Handling Restrictions: n/a
Reference: n/a
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 20-Oct-2004 12:00:00 am
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 2084502
Secure: OPEN
Status: NATIVE
Subject: BANK OF ENGLAND QUARTERLY BULLETIN SUMMARY: THE BANK OF ENGLAND'S LATEST QUARTERLY BULLETIN PRESENTS A POLICY ASSESSMENT LOOKING BEYOND THE IM
TAGS: EFIN, UK, BANK OF ENGLAND
To: STATE TRSY
Type: TE
vdkgvkey: odbc://SAS/SAS.dbo.SAS_Docs/8b506479-c288-dd11-92da-001cc4696bcc
Review Markings:
Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
22 May 2009
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 22 May 2009